SRI PALMAR DEVELOPMENT & CONSTRUCTION SDN. BHD.

v.

TRANSMETRIC SDN. BHD.

HIGH COURT, SHAH ALAM
DATO' MAHADEV SHANKAR J.
[ORIGINATING SUMMONS NO. 24-210-92]
8 FEBRUARY 1993

CONTRACT: Building contract - Enforceability of performance bond.

The case involved a building dispute between a main contractor and its sub-contractor.

In 1989, the plaintiff ('SP') entered into a joint venture agreement, with the State Secretary Selangor (Incorporated) (SSSI) to implement a housing development scheme on some land in Kuala Langat ('the site'). SP entered into a building contract in August 1991 with the defendant ('TM') for the construction of the housing development. The contract required TM to provide SP with a performance bond and there was an arbitration clause. Personal guarantees were executed on behalf of the parties for the performance of the obligations under the contract. The goods, materials and services required were to be provided by Selangor Industrial Corporation Sdn. Bhd. (SIC). TM assigned absolutely to SIC all moneys receivable by TM from SP for work done to the extent of the value of SIC's invoices for goods etc. supplied to the site. TM went into possession of the site and commenced work.

In January 1992, TM was given notice requiring it to get its earth supplies from Sim Huat Hin Lorry Transport Agent as a nominated sub-contractor. TM did not do so. Earth filling operations came to a stand-still.

In February 1992, the Malaysian Assurance Alliance Berhad (MMA) guaranteed the performance of a contract whereby TM undertook the erection and completion of a housing project in Tanjong Sepat. The bond was for RM328,100, and was the bond referred to in the building contract.

By a letter dated 3 March 1992, SP gave TM notice of default. TM treated it as a notice of termination and challenged its validity. On 26 March 1992, SP terminated the contract. TM refused to accept the termination. They contended that they would refuse to vacate the site, claim for specific performance and compensation for damage sustained.

SP applied to the Court for an order for immediate possession. On 20 April, the Court heard the matter on grounds of urgency. It ordered that TM vacate the premises subject to the reservation of all the rights which might be made the subject of arbitration proceedings, and further made subject to SP being restrained from calling in the performance bond unless they were able to establish to the satisfaction of the court that they were legally entitled to do so.

The parties resorted to arbitration. In May 1992 SP filed an application for an order that the restraint upon them calling in the performance bond be lifted. The Court held that the restraint must be lifted and SP be allowed to call in the bond. TM applied for further argument and for a stay of execution pending the conclusion of the arbitration.

Held:

[1] No further argument was required.

[2] The application for stay must be dismissed. To hold otherwise would be to make an unwarranted intrusion on SP's rights against the MAA who were not parties to TM's disputes with SP.

However much the Court might sympathise with the plight of TM, it had to dismiss the application because the terms of the bond left the Court with no choice. SP were legally entitled to call the bond in, as it was made payable on SP's demand notwithstanding any contest or protest by the contractor. The Court had to take the bond as it found it.

[Application dismissed].

Cases referred to:

Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. & Umma Bank [1977] 6 BLR 1 ***(refd)***

Malaysia Overseas Investment Corpn. Sdn. Bhd. v. Sri Syarikat Supermarket Sdn. Bhd. [1986] 2 MLJ 382 ***(refd)***

Kiramas Sdn. Bhd. v. Federal Land Devpt. Authority [1991] 2 CLJ 1366 ***(refd)***

Kejuruteraan Awam Lang Lang (M) Sdn. Bhd. v. The Standard Chartered Bank [1991] 3 CLJ 2502 ***(refd)***

Suffian Aziz & Rakan-Rakan v. Majlis Perbandaraan Klang and Malaysia Berhad Assurance Bhd. [Shah Alam High Court OS 24-290-90 - Unreported] ***(refd)***

For the plaintiff - C.F. Lim; M/s. Azman, Davidson & Co.

For the defendant - Y.S. Ngeow; M/s. Ngeow & Maurice Gomez

JUDGMENT

Mahadev Shankar J:

This is a building dispute between a main contractor and its sub-contractor. The first issue was repossession of the site after an alleged wrongful termination of the sub-contract. The second issue is the enforceability of the performance bond.

On 21 March 1989 the plaintiff (hereafter referred to as SP) entered into a joint venture agreement with the State Secretary Selangor (Incorporation) (SSSI) to implement a housing development scheme on some land at Tanjong Sepat Kuala Langat. This land belonged to the SSSI and is hereafter referred to as "the site".

After the design of the housing development scheme was completed and approved by the relevant authorities SP entered into a building contract on 30 August 1991 with the defendant (hereafter referred to as TM) for the construction of the housing development. This building contract is a very comprehensive document. Suffice it to say here that it required TM to provide SP with a performance bond and there was an arbitration clause. The gross development value of the contract was in excess of RM39 million.

Concurrent to the building contract SP's managing director and his wife executed a personal guarantee in favour of TM as collateral security for the performance of SP's obligations under the building contract aforesaid (hereafter referred to as 'the building contract'). Likewise two executive directors of TM executed a personal guarantee in favour of SP as collateral security for the performance of TM's obligations under the building contract.

The goods, materials and services required for the housing development was to be provided by Selangor Industrial Corporation Sdn. Bhd. (SIC). SIC had to be paid for this. TM had to be paid by SP for the work which TM did under the building contract. On the same day i.e. 30 August 1991 TM assigned absolutely to SIC all moneys receivable by TM from SP for work done to the extent of the value of SIC's invoices for goods, materials and services supplied to the site.

Thereafter TM went into possession of the site and commenced the works required. SP complains that TM was slow. Instead of completing the show house within eight weeks of the targetted date of commencement on 13 September 1991, SP says TM only started on 3 November 1991 and only achieved substantial completion in late February 1992.

Earth filling works at the site was supposed to be done by a nominated sub-contractor. But by mutual agreement SP allowed TM to carry out these works initially. SP alleges that TM submitted such exorbitant claims both in respect of price and the quantity of earth delivered that TM had to be stopped from carrying out any further earth filling works.

In January 1992 SP's architect gave TM a written notice requiring TM to get its earth supplies from Sim Huat Hin Lorry Transport Agent as a nominated sub-contractor. TM did not do so. SP's architect sent a reminder on 13 February 1992. TM replied on 23 January to the architect that he had not followed the proper procedures of SIC. By that time it appears that the earth filling operations had come to a stand still.

It is in the midst of this change of the identity of the earth supplier that the performance bond made its appearance. On 6 February 1992 the Malaysian Assurance Alliance Berhad (MAA) guaranteed the performance of a contract whereby TM undertook the erection and completion of 439 units of 2 Bedroom Low Cost House (Phase 1) at Main Lot 1101 Tanjung Sepat etc. for a sum of RM6,562,000. The bond was for RM328,100. Although the date of the building contract referred to in the bond is left blank, the description of the works, its value, and the amount of the bond at 5% of the contract sum leaves one in no doubt whatsoever that this performance bond was the one referred to in the building contract. (See Annexure A Phase 1).

By a letter dated 3 March 1992 SP's architect gave notice of default to TM for suspension of earth filling and construction works. TM responded on 12 March. They treated the notice of default as a notice of termination and challenged its validity. TM stated that by halting the earth filling works being done by TM and requiring a nominated sub-contractor, TM had no obligation to continue earth filling till SP had concluded the formalities for the earth supplied from Sim Heng Chuan. As to cessation of construction TM contended that SP had not given them possession of the specified sites where the rows of houses were to be located. Obviously a dispute had arisen which TM required to be

referred to arbitration under clause 34 of the conditions of the building contract.

SP responded on 20 March 1992 stating that the architects notice was a notice of default and not a notice of termination. Nevertheless SP gave notice that if the earth filling works were not resumed by 25 March, SP would terminate the building contract in accordance with general condition 25.

On 26th March SP carried out their threat and terminated the building contract. By letter dated 31 March TM's solicitors refused to accept the termination, and claimed that TM would keep the contract open subject to their claim for damages for wrongful termination. A further notice followed on 1st April. TM contended that they would refuse to vacate the site, claim for specific performance, and compensation for damage sustained.

Meanwhile the SSSI had reconstituted itself as the Permodalan Negeri Selangor Berhad (PNSB) who gave notice to SP to show cause why the joint venture agreement should not be aborted. The delay in completion had been inordinate. If PNSB cancelled the whole scheme would be at risk. In response to SPP's entreaties to keep the joint venture agreement open, PNSB extended time for various recommencement of the construction works to 30 April 1992.

As TM had barricaded the entrances into the site SP came before me for an order for immediate possession. A breach of the peace seemed imminent. On grounds of urgency I heard both Counsel on 20 April 1992. I formed the view that this was not an appropriate case for specific performance since the Court could not undertake any effective supervision. TM's claim, if it could be substantiated, was for damages. The value of the work they had done on site had to be quantified. This was merely a matter for measurement by qualified quantity surveyor. I therefore ordered that the plaintiff furnish their land surveyor's report to the defendants who could then get their quantity surveyor to complete his measurements. By 27th April this was done. Before me the plaintiffs were prepared to accept the defendant's quantity surveyors evaluation, and defendants solicitors indicated that TM was prepared to vacate the site subject to their claims being arbitrated and the plaintiff being restrained from calling in the performance bond unless it was established that the plaintiffs are legally entitled to do so.

To this proposal Mr. C.F. Lum SP's Counsel agreed and I made an order as follows:

> I order that the defendants do vacate the site today subject to the reservation of all the rights which may be made the subject of arbitration proceedings under their contract with the plaintiffs and further subject to the plaintiff being hereby restrained from calling in the performance bond unless they are able to establish to the satisfaction of this Court that they are legally entitled to do so.
> Liberty to apply.
> Case adjourned *sine die*.
> Costs in the cause.

It would appear that thereafter the parties resorted to arbitration. On 21 May 1992 SP filed an application for an order that the restraint upon them calling in the performance bond be lifted.

I heard this application on 18 August 1992. TM's solicitors appeared to be under the impression that SP should not be allowed to enforce the performance bond until the arbitration proceedings were concluded.

With respect to them, the plain meaning of the order I made on 27 April 1992 was that if SP could show this Court that they were legally entitled to call in the bond then they could so. The answer to that question depended on the terms of the bond.

This was a bond payable on SP's "demand notwithstanding any contestation or protest by the contractor ..."

The legal effect of such working has been too well established to permit any further quibling. I was referred to the following authorities:

(1) *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. & Umma Bank* [1977] 6 BLR 1 at p.11.
(2) *Malaysia Overseas Investment Corpn. Sdn. Bhd. v. Sri Syarikat Supermarket Sdn. Bhd.* [1986] 2 MLJ 382 at 384.
(3) *Kiramas Sdn. Bhd. v. Federal Land Dvpt. Authority* [1991] 2 CLJ 1366 at p. 1368.
(4) *Kejuruteraan Awam Lang Lang (M) Sdn. Bhd. v. The Standard Chartered Bank* [1991] 3 CLJ 2502 at 2504.
(5) See also *Suffian Aziz & Rakan-Rakan v. Majlis Perbandaraan Klang and Malaysia Berhad Assurance Bhd.* [Shah Alam High Court SP 24-290-90 - Unreported].

Undoubtedly TM had "contestations and protests" against SP and SP's architect which raised serious questions to be tried as between TM and SP. The architect was in fact a director of SP and the credibility of his certificates were under serious attack. There was also a non-accounting of moneys allegedly due to TM in the sum of RM116,500 for the show houses and RM96,550 for the earth filling.

But these are questions to be resolved between TM and SP in the arbitration.

So I took the view that the law gave me no alternative but to lift the restraint upon SP and allow them to call in the bond. I made an order accordingly on 18 August 1992 with costs.

TM then changed their solicitors and applied for further argument and for a stay of execution pending the conclusion of the arbitration. On 29 September 1992 I indicated I did not require further argument. I also dismissed the application for stay because to hold otherwise would be to make an unwarranted intrusion on SP's rights against the MAA who are not parties to TM's disputes with SP.

It was most strenously submitted by TM's Counsel that if SP was not stopped from calling in the bond, or at least not prevented from using the moneys paid by MAA until the disposal of the arbitration, iniquitous results would follow. It was claimed that for all the work done by TM, it had not yet been paid a single cent. Further it was said that SP was in serious financial difficulties and that if they got their hands on the moneys that was the last that TM would see of it. A most persuasive argument was also mounted to the effect that as the building contract had not yet begun, it could not be terminated.

But much as I sympathised with the plight of TM I regret that there was nothing this court could do but to dismiss the application because the terms of the bond, in my view left the court with no choice. This court is not unaware that an unscrupulous employer can easily cheat an unsuspecting contractor by calling in the bond on some flimsy pretext and thereby get an immediate windfall of ready cash, leaving the contractor with the frustration and pain of a protracted law suit which could take years to resolve. Alternatively an incompetent contractor may choose to abandon the works because it has become unprofitable for him to continue, and so put the employer in the lurch unless there is a performance bond which gives him ready money to get somebody else to carry on and complete the works invariably at a higher cost. But these are not considerations of immediate relevance because the court must take the bond as it finds it. Parties are always at liberty to word the bond so that it compels the insurance company to pay but ensures that the moneys so paid are frozen until the respective merits of the claims and counterclaims are both fully ventilated and disposed of.